

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Nicholas J. Singer
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(Large & Mid-Size Business)

from: Branch Chief, Branch 7, CC:ITA:7
(Income Tax & Accounting)

subject: Treatment of American Viticultural Area Designation Under Section 197

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Taxpayer =

Date =

Location A =

Location B =

X =

Y =

ISSUE

When Taxpayer purchased a vineyard that is located in an American viticultural area ("AVA"), is the amount of the purchase price allocated by Taxpayer to the right to use the AVA designation an amortizable § 197 intangible?

CONCLUSION

For § 197 purposes, the right to use an AVA designation is a license, permit, or other right granted by a governmental unit and is not an interest in land. Therefore, the right to use an AVA designation is a § 197 intangible and the amount of the vineyard's purchase price allocated by Taxpayer to the right to use the AVA designation is an amortizable § 197 intangible.

FACTS

On Date, Taxpayer purchased a vineyard in the Location A viticultural area and the Location B viticultural area. The Alcohol and Tobacco Tax and Trade Bureau ("TTB") of the United States Department of the Treasury has approved the Location A viticultural area and the Location B viticultural area as AVAs. Taxpayer allocated a portion of the purchase price to the right to use the AVA designation and treats such allocated amount as an amortizable § 197 intangible.

LAW AND ANALYSIS

Section 197(a) of the Internal Revenue Code provides that a taxpayer shall be entitled to an amortization deduction with respect to any amortizable § 197 intangible. Section 197(c)(1) provides that, in general, the term "amortizable section 197 intangible" means any § 197 intangible which is acquired after August 10, 1993, and which is held in connection with the conduct of a trade or business or an activity described in § 212.

Section 197(d)(1)(D) provides that the term "section 197 intangible" means, among other things, any license, permit, or other right granted by a governmental unit or an agency or instrumentality thereof. Section 1.197-2(b)(8) of the Income Tax Regulations provides that § 197 intangibles include any license, permit, or other right granted by a governmental unit (including for purposes of § 197, an agency or instrumentality thereof) even if the right is granted for an indefinite period or is reasonably expected to be renewed for an indefinite period. These rights include, for example, a liquor license, a taxi-cab medallion (or license), an airport landing or takeoff right (sometimes referred to as a slot), a regulated airline route, or a television or radio broadcasting license.

Section 197(e)(2) provides that the term "section 197 intangibles" does not include, among other things, any interest in land. Section 1.197-2(c)(3) provides for this purpose, an interest in land includes a fee interest, life estate, remainder, easement, mineral right, timber right, grazing right, riparian right, air right, zoning variance, and any other similar right, such as a farm allotment, quota for farm commodities, or crop acreage base. However, an interest in land does not include an airport landing or takeoff right, a regulated airline route, or a franchise to provide cable television service.

The TTB has promulgated regulations relating to AVAs in 27 CFR Part 9. 27 CFR § 9.3 provides the procedures for submitting a petition (including the information to be

included in such petition) to the Administrator to establish an American viticultural area. The Administrator is defined in 27 CFR § 9.11 as the Administrator of the TTB.

Pursuant to 27 CFR § 9.11, a viticultural area is defined as a delimited grape growing region distinguishable by geographical features, the boundaries of which have been delineated in Subpart C of 27 CFR Part 9 (Approved American Viticultural Areas). 27 CFR § 9.21 provides that the viticultural areas listed in Subpart C of 27 CFR Part 9 are approved for use as appellation of origin in accordance with 27 CFR Part 4. Two of these approved American viticultural areas are the Location A viticultural area as described in 27 CFR § X and the Location B viticultural area as described in 27 CFR § Y.

In addition, the TTB has promulgated regulations relating to AVAs in 27 CFR Part 4 with respect to the labeling and advertising of wine. Under 27 CFR § 4.23(a), the names of one or more grape varieties may be used as the type designation of a grape wine only if the wine is also labeled with an appellation of origin as defined in 27 CFR § 4.25(a). 27 CFR § 4.25(a)(1) provides that for American wine, an American appellation of origin is: (i) the United States; (ii) a state; (iii) two or no more than three states which are all contiguous; (iv) a county (which must be identified with the word "county" in the same size of type, and in letters as conspicuous as the name of the county); (v) two or no more than three counties in the same states; or (vi) a viticultural area as defined in 27 CFR § 4.25(e). 27 CFR § 4.34(b) provides in pertinent part that an appellation of origin disclosing the true place of origin of the wine shall appear in direct conjunction with and in lettering substantially as conspicuous as the class and type designation if a varietal (grape type) designation is used on the label.

For purposes of 27 CFR Part 4, a viticultural area for American wine is defined in 27 CFR § 4.25(e)(1)(i) as a delimited grape growing region distinguishable by geographical features, the boundaries of which have been recognized in 27 CFR Part 9. 27 CFR § 4.25(e)(3)(i), (ii), and (iv) provide that in the case of American wine, a wine may be labeled with a viticultural area appellation only if the appellation has been approved under 27 CFR Part 9, not less than 85 percent of the wine is derived from grapes grown within the boundaries of the viticultural area, and it has been fully finished within the state or one of the states, within which the labeled viticultural area is located. 27 CFR § 4.25(e)(2) provides that petitions for establishment of American viticultural areas may be made to the Administrator by any interested party.

The TTB approves the areas established as AVAs. Any winemaker regardless of whether they have petitioned to establish an AVA may use an AVA designation on its wine bottle label if that winemaker meets the requirements set forth by the TTB. These requirements are that the viticultural area appellation has been approved by the TTB under 27 CFR Part 9, not less than 85 percent of the wine is derived from grapes grown within the boundaries of the viticultural area, and it has been fully finished within the state or one of the states, within which the labeled viticultural area is located. Accordingly, the right to use an AVA designation is a right granted by a governmental

unit and is a § 197 intangible within the meaning of § 197(d)(1)(D).

However, an interest in land is not a § 197 intangible. Section 1.197-2(c)(3) provides a nonexclusive list of examples of interests in land. For this purpose, an interest in land includes a fee interest, life estate, remainder, easement, mineral right, timber right, grazing right, riparian right, air right, zoning variance, and any other similar right, such as a farm allotment, quota for farm commodities, or crop acreage base. Arguably, the AVA designation is an interest in land because the grapes producing the wine are harvested from the vineyard and the vineyard is land. However, the AVA designation applies to one of the uses of a particular crop from any land within the designated viticultural area, which is further processed into a finished product. It is not the right to or a limitation on the uses or product of a particular piece of land within the designated viticultural area. Consequently, the AVA designation is not similar to any of the enumerated examples of interests in land as stated in § 1.197-2(c)(3) and, thus, is not an interest in land under § 197(e)(2) and § 1.197-2(c)(3).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

We have concerns about how a taxpayer would value the right to use an AVA designation. It is unclear whether the value of the right to use an AVA designation attaches to an acquisition of a particular vineyard within an AVA. The benefit in value from the right to use an AVA designation accrues to all land whose highest and best use is as a vineyard within such designated viticultural area. Consequently, all of the closest comparable vineyards share the same intangible benefit thereby making an appraiser's determination of the increment of value assigned to the intangible benefit and finding comparable vineyards outside of the particular AVA factually difficult.

In addition, § 197(f)(8) provides that § 197 shall not apply to any increment of value if, without regard to § 197, such increment is properly taken into account in determining the cost of property (the land and tangible improvements) that is not a § 197 intangible. Without § 197, the benefit of an AVA designation to a vineyard would be subsumed into the value of the land and improvements. Only if there was a factual showing of some clear premium, such as a recognized and marketable tradename to a taxpayer's vineyard, would an intangible asset be recognized.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-4930 if you have any further questions.

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